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Blockage of shipping lines in the Suez Canal and ramifications for the Strait of Hormuz

Asian crude importers need to proactively consider remediation plans to safeguard their energy security needs should a military misadventure render the Strait of Hormuz unnavigable.

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Since Tuesday, vessel movement through the Suez Canal remains suspended after a large container vessel ran aground, blocking the Canal and bringing all marine traffic on this busy trade passage to a complete halt (see Fig 1).

Figure 1:

The Suez Canal is a critical shipping trade route which connects the Mediterranean and Red Seas, through Egypt, thus reducing East – West shipping time by allowing vessels to cut across without having to go all the way around the southern tip of Africa – on an average vessels can slash their navigation distance by almost 12,000 Kms thereby saving around 14 days of valuable sailing time.

Its significance, and vector can be gauged from the fact that on an average nearly 50 vessels pass along the canal every day - accounting for some 12% of world trade. In 2020, a total of 18,829 ships passaged through carrying nearly 1.2 Bn tonnes of cargo.

This channel is a crucial cog in the world's energy trade, transporting Middle Eastern crude to Europe and the United States, as well as shipping petchem products from the West to the East. Every day about 600,000 barrels of crude flow from the Middle East to Europe and the US, via the canal, and about 850,000 barrels from the Atlantic Basin to Asia. In addition, 400,000 barrels of naphtha sail eastwards each day with 300,000 barrels of middle distillates (like diesel, kerosene, jet fuel) headed from Asian refineries to the West.

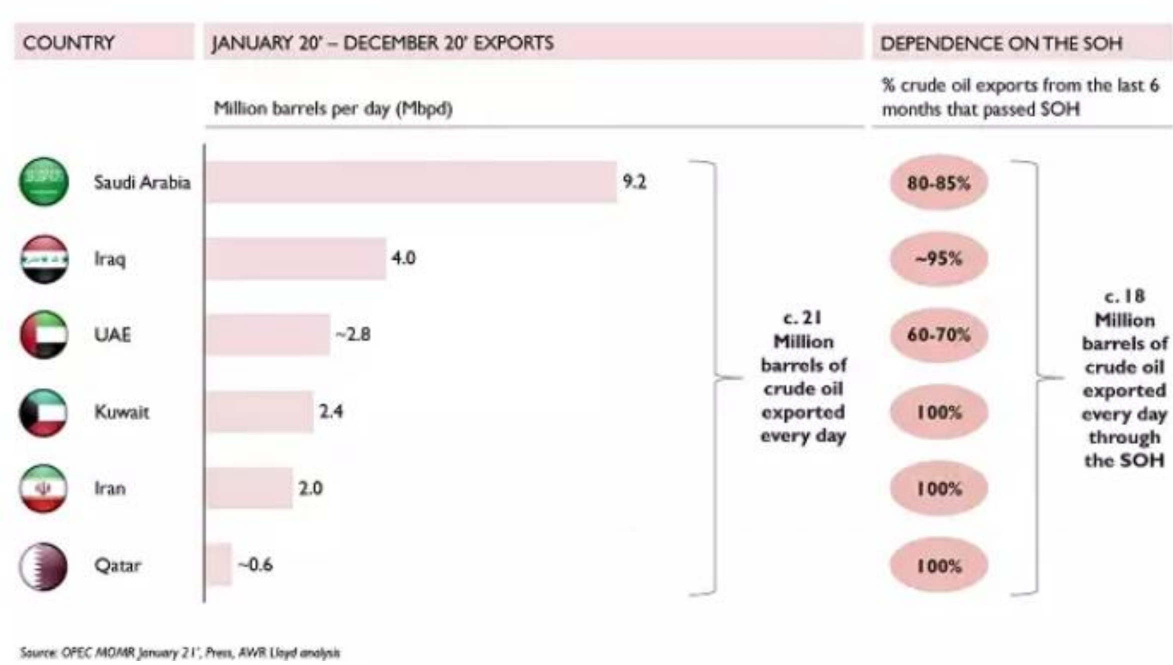
However, there is another more critical risk to global commerce, and the crude oil trade in particular, which ferries nearly three times the crude volumes handled by the Suez Canal; the Strait of Hormuz.

The Strait of Hormuz is a narrow waterway that links the Persian Gulf with the Gulf of Oman and the Arabian Sea. At its narrowest point, the waterway is only 21 miles wide, and the width of the shipping lane in either direction is just 2 miles, separated by a 2-mile buffer zone (see Fig 2).

Figure 2: The Strait of Hormuz

It is a key maritime transit route through which most Gulf countries export crude oil, LNG and refined products. Nearly 18 Mn barrels of crude are exported by key OPEC exporters like Saudi Arabia, Iraq and Kuwait - which accounts for almost 30% of the global oil seaborne trade (see Fig 3).

Fig 3: Main crude oil exporters and their dependence on the Strait



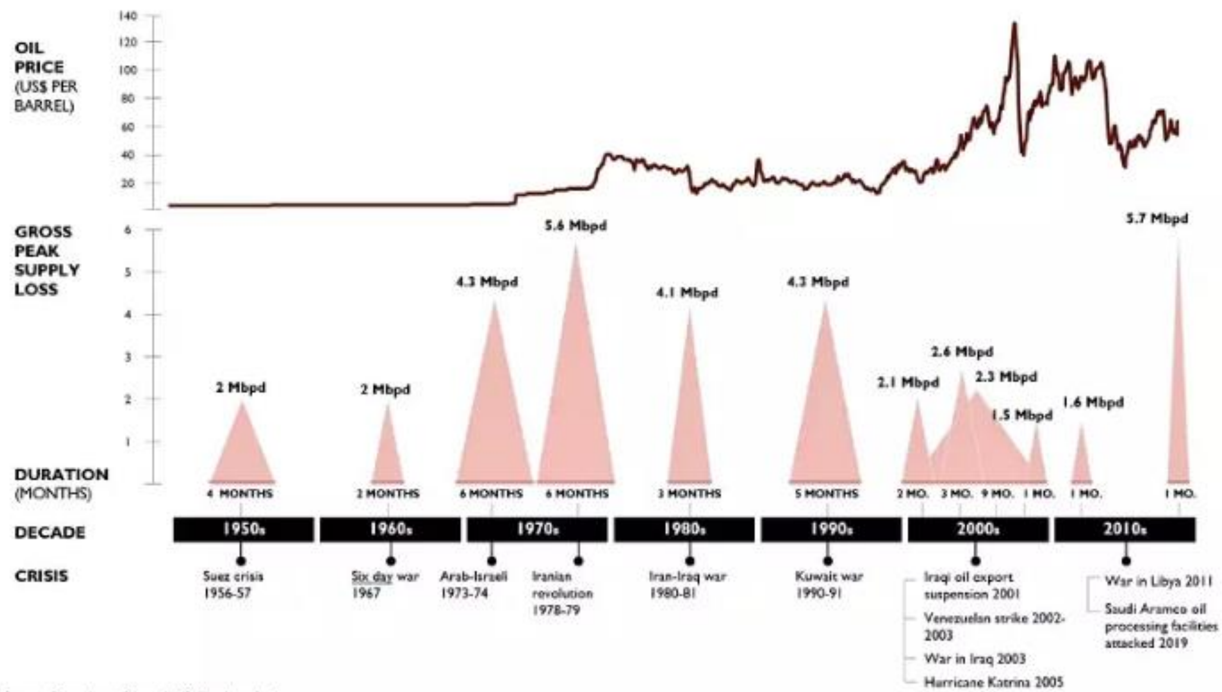
The Strait's geopolitical magnitude means it has long been a focal point of international tensions between Tehran and the West, which have only increased in recent times, with Iran threatening to close this vital passage by means of sabotage or naval interference.

Iran has always considered the Strait of Hormuz to be an ace up its sleeve, and a significant bargaining chip should the West, primarily the US, were deemed to act in any way detrimental to Tehran's strategic and/ or military interests. Former Iranian Prime Minister Hoveida once called it "our jugular vein," More recently, Major General Jafari of the Iranian Revolutionary Guard, made a statement in 2018 that, "Enemies know that we are easily able to block the Strait of Hormuz for an unlimited period"

It is against the backdrop of this sabre rattling from Iran, and its open threat of disrupting shipping traffic (and more importantly crude oil exports) that makes any misadventure around the Strait of Hormuz a clear and present danger for the global economy. Past experience shows that the world does not respond well to supply side interruptions and when crucial barrels of oil are taken out from the market – which then leads to price shocks that have the ability to impinge several fiscal pain on crude importing nations as well as the world economy.

In the past crude oil prices have, predictably, soared each time there is a crisis in the Middle East – for example oil prices jumped two-and-a-half times during the Arab oil embargo in 1973, almost doubled during Iraq's invasion of Kuwait in 1991, increased by about 30 per cent during the Libyan crisis, and more recently, went up 20 per cent the day after the 14 September 2019 Abqaiq strikes in Saudi Arabia (see Fig 4).

Fig 4: Historical analysis of global oil supply disruptions



Source: Bloomberg, Press, AWR Lloyd analysis

Given this volatile mix of belligerence and public posturing which has the ability to drastically impair the global economy, Asian crude importers need to proactively consider remediation plans to safeguard their energy security needs should a military misadventure render the Strait of Hormuz unnavigable. Enhancing strategic crude storage plans as a defence against price spikes and supply stoppages is one of the most practical approaches being adopted by several countries around the globe.

In such a geo-politically uncertain world, it would make logical sense for import dependent countries like India to implement a concerted push towards construction of strategic petroleum reserves (SPR's) - both in the country as well as in neutral and risk free geographies away from the conflict areas in the Gulf, that can be tapped into in the event of an emergency.

[This piece was authored by Rajat Kapoor, Managing Director - Oil & Gas, AWR Lloyd]

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